The role of real estate in a Capital Markets Union

Supplementary document to the Green Paper Questionnaire

"The Commission's priority – Europe's priority – is jobs and growth. To get Europe growing again, our challenge is to unlock investment in Europe's companies and infrastructure".

The opening lines of the Green Paper succinctly set out the overarching objectives that the Capital Markets Union (CMU) project is meant to deliver. The Green Paper explores a number of different measures that could support these goals and we have set out our thoughts on these in the dedicated Questionnaire.

This paper adds to those responses, and focuses in particular on the enabling role that the real estate industry can play in delivering jobs and growth in Europe. Although it is an addendum to the Questionnaire, it reiterates the key points of EPRA's response to the CMU initiative.

An introduction to the real estate sector

We are surprised that the CMU Green Paper does not make greater reference to real estate. We believe that there are a number of CMU-related measures that would help unlock the potential of real estate in supporting greater cross-border capital flows as well as job creation and economic growth, namely:

1. Attracting investment to Europe
2. Infrastructure and real estate underpinning growth in the economy
3. Helping SMEs start-up and grow

Real estate, as a general term, describes the built environment, which plays a vital role in every aspect of the European economy, society and environment. Businesses and society cannot function without the services of commercial real estate, including the provision of offices, shops, factories, housing, healthcare, hospitals and many other forms of real estate. Approximately 50% of EU businesses rent their premises - the commercial real estate sector delivers and manages the infrastructure needed for entrepreneurship to thrive. The efficiency of the process through which the European real estate industry invests, develops, supports, and maintains a sustainable built environment, and services its clients, is of crucial importance to policy-makers.

Contribution to jobs and growth

In 2013, the commercial real estate sector directly contributed €302 billion to the European economy, representing about 2.6% of the total economy – and more than both the European automotive and telecommunications sector combined. It employs 3.8 million people, which is more than the automotive, telecommunications and banking sectors together.[1]

Most activity in the commercial real estate sector is through the development, refurbishment and repair of buildings. The upkeep, management and care of commercial buildings are also a sizeable activity, undertaken either directly by real estate owners or on their behalf by a growing number of specialist contractors. All of these activities are an essential part of

[1] Real Estate in the Real Economy, Summer 2014

European Public Real Estate Association
Square de Meeus, 23
1000 Brussels, Belgium

T: +32 (0) 2739 1010 **F**: +32 (0) 2739 1020 **W**. www.epra.com

maintaining and improving the quality of the accommodation services provided to businesses.

EPRA believes there are three key areas of the Green Paper in which real estate and more specifically the listed real estate sector and REITs can help the Commission achieve its goals of long-term investment and growth. These are as follows:

1. Attracting investment to Europe

a. EU investment

Long-term institutional investors spearhead urban regeneration projects. They contribute to the rejuvenation of city centres through the provision of retail, leisure, education and health facilities. Importantly, real estate investment provides attractive yields along with long-term cash flows and portfolio diversification, while matching long-term liabilities. This safeguards the viability of long-term investing and is critical for providing the income needed for European pensioners and savers.

On average, global allocations are in the region of 10% of total assets for pension funds. For example, two of the largest pension funds in Europe, APG and PGGM from the Netherlands, both invest over 10% of total assets in real estate and infrastructure. A significant portion of this is in the form of listed real estate and REITs, as it provides them with exposure to high quality assets, professional management and stable income.

As the need to boost defined contribution schemes increases, demand for high quality, high yield, liquid investment products is essential. For example in the UK, the National Employment Savings Trust (NEST) has a 20% allocation to infrastructure and real estate – of which REITs play an important role. In the US, 401(k) investors plan can opt to invest in real estate through REITs.

From an investment perspective, a broader range of outreach and education initiatives are required to help non-EU investors clearly understand the benefits of investing in the EU. Greater accessibility to investment data, indices and research will help EU firms promote themselves more broadly. EPRA has been hugely successful in attracting global institutional capital into EU REITs.

The promotion of EU REITs through the FTSE EPRA/NAREIT Index series has attracted capital directly into individual constituent REITs, mutual funds tracking the FTSE EPRA/NAREIT Index series and low-cost exchange traded funds (ETFs). In ETFs, managed by fund managers such as BlackRock and AXA, we have attracted assets under management with a value of over USD 10.5 billion. The vast majority of the institutional fund management industry uses the FTSE EPRA/NAREIT Index series as their benchmark of choice for listed real estate and REITs investment.

In relation to green bonds, EPRA's members are already at the forefront of this new market, which has grown steadily in the last 12 months. EU based real estate companies have issued green bonds worth over EUR 1.5 billion.

European Public Real Estate Association
Square de Meeus, 23
1000 Brussels, Belgium
T: +32 (0) 2739 1010 **F**: +32 (0) 2739 1020 **W**. www.epra.com

b. Regulation

Unfortunately, Solvency II imposes equity-level (39%) capital requirements on REITs which act as a hurdle to investment. We strongly believe that long-term real estate capital requirements of 25% – the same level as the direct real estate market – would help attract much-needed insurance capital into REITs in order to fund long-term real estate ownership, refurbishment and development, and the related infrastructure. There is a large base of academic evidence that proves that listed real estate and REITs perform the same as direct real estate over the medium to long term. We recommend the reduction of the capital requirement to 25% in order to lower the investment hurdle.

In addition, we urge the Commission to remove any barriers (i.e. double taxation) to multinational trade and investment. We strongly encourage the broader adoption of national REITs structures across the EU and their mutual recognition across borders. REITs have proved to be transparent and liquid vehicles which attract EU and non-EU investment into long-term real estate and infrastructure projects in Europe. Recent REIT introductions in Spain and Ireland have resulted in over EUR 5 billion of equity raised.

We believe the broader adoption of national REITs across the EU and cross-border recognition of such, will facilitate global investment in an internationally recognised institutional investment vehicle, and insure investment is channelled to where long-term investment is required. The growth and success of the US REITs industry over the last 25 years is a good example of the potential inward global investment to the EU that could come from an internationally recognised investment vehicle.

2. Infrastructure and real estate underpinning the economy

Real estate and infrastructure both form an integral part of our urban environment and to a significant extent they are interconnected. Real estate development is generally only possible when it can be serviced with good transport, energy and communications infrastructure, while at the same time the provision or extension of such infrastructure often only makes sense where it will lead to future real estate development. Two of the largest infrastructure projects in Europe – Crossrail and Grand Paris – are a prime example of this. Billions of euros are being invested in the real estate around these projects – much of it by listed real estate companies and REITs, generating jobs, and housing business in modern and sustainable buildings.

It is also difficult to draw a line between real estate and infrastructure investment, particularly when it comes to social infrastructure such as healthcare, educational and leisure facilities. While in many European countries such facilities may historically have been provided by the State, private capital is increasingly looking to invest in such projects for both profit and social investment motives. In addition, real estate developers and landlords are often responsible for the urban infrastructure linked to their projects, such as green spaces, transport links and public information amenities. This further emphasises the connection between real estate and infrastructure. It is therefore important that the regulatory environment recognises the important role that real estate plays in the provision of infrastructure.

3. Helping SMEs establish and grow

A healthy real estate sector is vital for the success of SMEs. Real estate businesses provide firms of all sizes with the flexible and high-quality space they need in order to thrive. The real estate industry provides the operating environment and premises for a significant number of all EU businesses as mentioned earlier. A regulatory environment which encourages long-term global investment in real estate and infrastructure, where the capital is invested as demanded by industry and business, will provide the fundamental underpinning for their day-to-day operations and future growth. We have many successful examples of this throughout the EU EPRA membership, which are available on request.

Summary

EPRA believes that it can play an important role in helping the Commission achieve its goals under CMU. By attracting global investment into EU real estate and infrastructure projects, through the use of listed real estate and REITs, will help with much needed investment. However, regulation will need to be refined to achieve this goal. Solvency II capital requirements for listed real estate and REITs need to be reduced from 39% to 25% to the same capital requirement level as direct real estate. In addition, we strongly encourage the broader adoption of national REITs structures across the EU and their mutual recognition across borders. A healthy real estate sector, meeting the demands for business space both large and small is fundamental to the success of growth in the EU economy.

About EPRA

The European Public Real Estate Association is the voice of the publicly traded European real estate sector. With more than 200 active members, EPRA represents over €350 billion of real estate assets and 90% of the market capitalisation of the FTSE EPRA/NAREIT Europe Index. Through the provision of better information to investors, improvement of the general operating environment, encouragement of best practices and the cohesion and strengthening of the industry, EPRA works to encourage greater investment in listed real estate companies in Europe.